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No. 96-1627

In The
Supreme Court of the United States
October Term, 1996

THEODORE VAN ZELST and LOUANN H. VAN ZELST, JEAN VAN ZELST-BIERNER, RALPH E. BROWN and SUZANNE BROWN, BRADLEY ORVIETO and ANNE L. ORVIETO, and THEODORE D. VAN ZELST,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

REPLY TO BRIEF IN OPPOSITION

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INTRODUCTION

The government's Brief for the Respondent in Opposition (the "Opposition Brief" or "Opp. Br.") is most significant not for what it says but rather for what it fails to say. Specifically, it fails to cite a single case in which reliance on an *expert valuation* opinion was found to be unreasonable. The mandate of the First Circuit Court of Appeals in *McMurray v. Commissioner*, 985 F.2d 36 (1st Cir. 1993), and of the Ninth Circuit Court of Appeals in *Sammons v. Commissioner*, 838 F.2d 330 (9th Cir. 1988) is clear: a taxpayer is entitled to rely on a valuation opinion by a qualified expert even where the expert values property at a price many times that of the acquisition cost. Nothing states to the contrary *except for the lower court decisions in this case*.

The cases cited by the government, all of which deal with alleged reliance on accounting advice (as opposed to a valuation opinion), do not ameliorate this conflict. Instead, the cases only demonstrate just how exceptional the circumstances must be before reliance on any professional advice can be disregarded. The lower court's decision to impose negligence and valuation overstatement penalties on these petitioners who even went beyond the expert report and, in good faith, gathered their own supporting comparables was clear error warranting reversal.

Finally, the government, in the Opposition Brief, completely misses the point of the lower court's attribution of a desire for "sky-high" appraisals to the National Park Service. The court did not, as the government claims, state that the Park Service encourages "sky-high" appraisals merely "to point out that the interests of the Park Service and the Internal Revenue Service were divergent." Opp. Br., p.

8. It is more than passing strange that not only is there no reference to this claim in the record below; there is no suggestion of any such claim by the trial court that heard and decided the matter in the first instance. Rather, as even a cursory reading of the opinion clearly reveals, the court concocted this "fact" out of whole cloth specifically to denigrate Hawley, the expert recommended by the Park Service (as well as other government officials including the Deputy Undersecretary of the Department of Interior), so as to justify the court's unsupported and maverick conclusion that petitioners did not have a good faith basis for relying on Hawley's expert valuation report. This exercise in advocacy by the Court below is consistent with that Court's quoting from *Fodor's Alaska*, written nine years after the date of donation, and never previously refered to in these proceedings, as dispositive evidence of Alaskan conditions in 1985.

As we will further demonstrate below, the Opposition Brief filed by the government demonstrates, both by its words and by its silence, why this Court should grant petitioners' request for a writ of certiorari.

ARGUMENT

1. The government's principal argument is predicated upon two assertions: (1) to avoid negligence penalties, a taxpayer's reliance upon professional advice must be reasonable; and (2) the trier of fact's determination as to the reasonableness of a party's conduct is to be accepted absent clear error. Opp.Br., p. 6. What the government fails to mention, however, is that the case law very clearly sets out a standard for reasonable reliance—a taxpayer may reasonably rely on "substantive advice" from an expert which "involved the application of the [expert's] relevant

expertise." *Chakales v. Commissioner*, 79 F.3d 726, 730 (8th Cir. 1996), quoting in part from *United States v. Boyle*, 468 U.S. 241, 251 (1985). By ignoring this principle, the lower courts in this case rendered a decision which is: (a) squarely in conflict with the decisions made by other circuit courts of appeal; and (b) clearly erroneous.

The holding of the cases cited by petitioner including, most notably, the *McMurray* and *Sammons* cases, is that a valuation of property by an expert is precisely the type of "substantive advice" which insulates a taxpayer from penalties for relying thereon. Those courts both held that a taxpayer need not "second-guess" an appraisal, even one that ascribes a value to the property many times that of the purchase price, precisely because it is reasonable to rely on "well qualified appraisers." *McMurray*, 985 F.2d at 48; *Sammons*, 838 F.2d at 337. Signally, the government's own attorneys cannot cite to a single appellate court decision (or, indeed, any decision whatsoever) which found that a taxpayer could not reasonably rely on a valuation report submitted by a qualified expert. The case at bar, which so found in the face of: (1) a government-recommended expert's contemporaneous valuation; and (2) the additional, good-faith investigation by the taxpayers including an extensive analysis of comparable sales, is in stark conflict with the 1st and 9th Circuits, in *McMurray* and *Sammons*, and departs from the standard set by this Court in *Boyle*.

The cases cited by the government demonstrate the lack of support for the lower courts' decisions:

Sacks v. Commissioner, 88 F.3d 918 (4th Cir. 1996) involved a challenge to the imposition of penalties based upon alleged reliance on advice from the taxpayers' accountants. The taxpayers in that case, however, "could not

recall any specific advice [the accountant] gave them concerning the project.." 84 F.2d at 818. The "best [the taxpayers] were able to provide" was a letter written by the accountant describing "the partnership approach to be a 'viable investment' [which] had a 'better' chance of surviving an Internal Revenue Service challenge." 82 F.3d at 919, 920. The appellate court found this vague, unspecific advice, when coupled with the taxpayers' receipt of a prospectus warning that the investment "INVOLVE[D] A HIGH DEGREE OF RISK, INCLUDING MATERIAL FEDERAL INCOME TAX RISKS," did not insulate the taxpayers from the imposition of penalties.

Obviously, the facts of this case differ dramatically from those in *Sacks*. Petitioners' expert rendered specific "substantive advice" within the area of his relevant expertise. No warning as to potential risky tax consequences was ever received by Petitioners. Thus, unlike in *Sacks*, Petitioners in this case had every reason to rely on what they were told, and no reason to "second guess" the valuation. Accordingly, the government's citation of the *Sacks* case does not resolve the conflict between the decision of the Seventh Circuit and the decision of the First and Ninth Circuits in the *McMurray* and *Sammons* cases raised by Petitioners.

Chakales v. Commissioner, 79 F.3d 726 (8th Cir. 1996), like *Sacks*, did not involve a taxpayer's reliance on specific accounting advice. There, the "advice" was only "a generalized statement that [the taxpayer] could lose money on the transaction [in question]." 79 F.3d at 730. *Chakales* does not contradict Petitioners' fundamental premise (as set forth in *McMurray* and *Sammons*), i.e., that a taxpayer is entitled to rely on specific expert advice, such as the 50-page valuation report submitted by the Hawley Group. Indeed,

the *Chakales* court directly cites that very principal as controlling. 79 F.3d at 730.

In *Westbrook v. Commissioner*, 68 F.3d 868 (5th Cir. 1995) the taxpayers' underpayment stemmed from their own "garden variety" careless record keeping — they failed to record expenses incurred in the activity in which the expenses were sustained. 68 F.3d at 881. Clearly, the taxpayers in that case could not claim justifiable reliance on expert advice that was tainted because of their own malfeasance. In *Accardo v. Commissioner*, 942 F.2d 444 (7th Cir. 1991), the taxpayer could not even produce evidence that he relied on his tax preparer at all. These cases do not, and cannot, resolve the conflict between the Seventh Circuit's decision in this case, and the decisions in *McMurray* and *Sammons*.

The last two cases cited by the government -- *Goldman v. Commissioner*, 39 F.3d 402 (2nd Cir. 1994) and *Illes v. Commissioner*, 982 F.2d 163 (6th Cir. 1992) -- each involved advice received from someone with a known direct financial stake in the project in which the taxpayers invested. In *Goldman*, the accountant was known to the taxpayers to have signed the limited partnership agreement (the investment) as the partnership's sales representative. In *Illes*, the taxpayer knew that his accountant had a personal financial stake in the matter. In addition, the taxpayer in *Illes* could not identify any specific advice given to him by the accountant.

The Hawley Group had no personal financial stake in the valuation submitted to Petitioners. Accordingly, the government's citations of *Goldman* and *Illes* do not support the Seventh Circuit's decision in this case. Nor do these

cases resolve the conflict between the circuits raised by Petitioners.

McMurray and *Sammons* stand for the proposition that a taxpayer (even a sophisticated one) can rely *solely* on an expert's *valuation opinion* and avoid the imposition of negligence penalties The cases cited by the government state that a taxpayer must go beyond *an accountant's generalized comments* and do independent investigation. In this case, which involved a specific valuation opinion, Petitioners could have started and ended with Hawley's report -- but in an abundance of caution which ensured their good faith and prudence they did more, including comparable sales analysis and consideration of improvements. The Seventh Circuit's decision to uphold the imposition of negligence and overstatement penalties on Petitioners under these circumstances cries out for reversal.

The failure of the government to find and cite contrary authority cannot be overemphasized. These are the *only* cases the government uses to justify the lower courts' findings, and to dispute the existence of a conflict. None involved a valuation opinion. None stand for the government's proposition that Petitioners' reliance on such an expert opinion was in bad faith. All of the cases involve factual situations completely the opposite of the circumstances here. Simply put, the lower courts' decision is squarely in conflict with the *McMurray* and *Sammons* decisions, and it is erroneous. This court should accept the Petition for Certiorari and reverse the circuit court's decision.

2. The decision rendered by the Seventh Circuit in the case at bar is replete with statements and misstatements of "fact" which are totally *dehors* the record. The most egregious example of these creations of "fact" is as follows:

> "What the Regional Director [of the Park Service] defined as 'the best' [the Park Service's description of Hawley] may not have been what the Commissioner or Congress had in mind. The Park Service wants to encourage donations and the sky-high appraisals do so."

Pet. Br., A.15a.

The government, in the Opposition Brief, casually dismisses this unsupported fantasy as "no more than [a] state[ment] all [of] the obvious", and further states that the lower court really meant to point out that the interest of the Park Service and the IRS were divergent. Opp. Br., 8. This argument by the government is as disingenuous as were the Seventh Circuit's statements about the Park Service.

At no point in this case have Petitioners ever asserted that the Internal Revenue Service is bound to accept the valuation opinion rendered by any expert. Rather, Petitioners have always argued only that their reliance on an expert recommended by the government was reasonable, prudent and in good faith. To take the opposite position, as did the Seventh Circuit, produces a ludicrous result. What the court and the government have told Petitioners (as well as all future donors of property) is that it is unreasonable and imprudent to rely on a valuation made by an admittedly qualified expert who was recommended by one branch of the government if another branch should disagree with that expert's conclusion. There is absolutely no authority

whatsoever which even remotely hints at supporting this absurd proposition.

This point is critical -- if it was reasonable for Petitioners to rely on the Hawley Group's recommendation, there can be no imposition of a negligence penalty. The only way that the lower court could justify its decision to uphold the imposition of negligence penalties, therefore, was to somehow denigrate Petitioners' reliance on an expert recommended to them by the very government entity to which they were donating the property at issue. In direct conflict with *McMurray* and *Sammons*, the Seventh Circuit said that Petitioners in this case, because of their sophistication, should have second-guessed the Hawley Group evaluation report. And then, perhaps mindful of the fact that this decision created a conflict with the decisions of other circuits, the Seventh Circuit justified its conclusion by saying that the Park Service encouraged "sky-high appraisals," implying, if not directly stating, that Petitioners' should have known that the Park Service and its recommended appraisers were engaged in a conspiracy to generate appraisal numbers "ginned up to put one up over on the revenooers." Pet. Br. A.15a.

There can be no other interpretation of the Seventh Circuit's remarks, regardless of the spin the government now attempts to put on them in the Opposition Brief. This was not just an attempt to highlight the difference between the Park Service and the IRS -- that would, in the government's terms, be "stating the obvious." It was rather a deliberate and unsupported attempt to justify a decision which stated that Petitioners' acted in bad faith by relying on a government-recommended expert. There is no support in the record or in the law for this conclusion, which "so far depart[s] from the accepted and usual course of judicial

proceedings...as to call for an exercise of this court's power of supervision." U.S. Supreme Court Rule 10.1(a).

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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